APPENDIX II
COMMUNICATIONS WITH CONGRESS

MAY 21, 2004

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our April 16, 2004 hearing on "***China's Presence in the Global Capital Markets***."

This hearing addresses the charge in our mandate to examine "Chinese access to, and use of United States capital markets, and whether the existing disclosure and transparency rules are adequate to identify Chinese companies which are active in United States markets and are also engaged in proliferation activities or other activities harmful to United States security interests." This is a cutting-edge element of our broader look at the U.S.-China economic relationship.

At this hearing the Commission heard testimony from two panels of witnesses on the goals, methods and implications of Chinese firms' use of global debt and equity markets to raise capital. Witnesses expressed particular concern about the governance and transparency of Chinese enterprises listing on U.S. exchanges. Recently, these listings have come under increased scrutiny in light of the Securities and Exchange Commission's investigation into China Life's accounting irregularities and a trade secret theft and patent infringement suit brought in U.S. courts against Semiconductor Manufacturing International Corporation, two Chinese firms listed on the New York Stock Exchange. However, despite mounting investor apprehension, China's outreach to international capital markets continues to grow in size and frequency, with some analysts forecasting the volume of Chinese company initial public offerings (IPOs) in the global markets to be as high as $23 billion for 2004.

Accessing international capital markets is an important component of China's economic development strategy. Notably, despite the fact that Chinese private firms account for roughly 60 percent of the country's GDP, the Chinese government has permitted state-owned enterprises (SOEs) to launch the overwhelming majority of IPOs in global capital markets. Chinese SOEs listing on global capital markets generally remain under the control of the Chinese government whose corporate governance and disclosure practices differ significantly from U.S. norms. With billions of dollars in U.S. investor funds being attracted by these firms, it is vital to understand whether U.S. investors are being provided adequate information about these firms' governance and financial performance, and whether U.S. regulatory requirements are sufficient to capture this concern.

The Commission also heard testimony about potential linkages between listed Chinese firms and China's defense-industrial complex and weapons proliferation activities. Such security-sensitive activities could constitute a material risk to investors because of the possible negative impact on the share value and reputations of these enterprises. More fundamentally, the Commission is concerned about whether the U.S. Government is sufficiently monitoring this nexus and focused on the potential security implications.

The Commission will provide a comprehensive analysis of this issue, along with recommendations for Congressional action, as part of its upcoming report to the Congress.

Sincerely,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

APRIL 6, 2004

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our San Diego, CA field hearing on February 12 and 13, 2004 examining "China as an Emerging Regional and Technological Power: Implications for U.S. Economic and Security Interests." China's technology development, and the pivotal role it plays in the global supply chain for high-tech goods and services, has important implications for U.S. economic and security interests.

The Commission is mandated (P.L. 108–7) to assess the qualitative and quantitative nature of the shift of United States production activities to China, including the relocation of high-technology, manufacturing and research and development facilities. Additionally the Commission is directed to examine China's performance in protecting intellectual property rights, a key area of concern in U.S.-China high-tech trade.

During this field hearing, held on the campus of the University of California, San Diego, the Commission heard testimony from a number of scholars and representatives of California's technology industry. During the discussion, panelists highlighted several important themes:

China's High-Tech Development. The Chinese government has a coordinated, sustainable vision for science and technology development. Many Chinese high-technology developments have been spurred by policies the Chinese government has instituted to accelerate the growth of industries in this sector, which the government believes can help lift the whole economy.

The Chinese government uses foreign investment, technology standards, and industry regulation to catalyze the nation's technological growth. Government procurement remains a lever for technology policy, as do proprietary technology standards. If foreign companies adopt Chinese promulgated standards to get access to the growing Chinese market, they help build economies of scale, which then encourages the growth of exports out of China with these new standards. An example of this is China's new wireless LAN standard. The Chinese government also uses its power over state corporations, and over companies that require licenses to produce or provide services, to organize bargaining cartels with foreign corporations to encourage technology transfers into China.

Several hearing panelists noted the importance of China's high-tech development to U.S. computer and electronics firms who are using it as a production base. One panelist noted that American computer and electronics firms had a rate of return in China of over 20 percent in 2002. Such profits encourage them to go along with Chinese ground rules for technology transfer. China is already the second largest computer manufacturer in the world, and it is expected that higher valued jobs in design, development and engineering will follow manufacturing to China.

China is also making strides in the advanced fields of pharmaceutical and biotechnology production. Products manufactured by China's pharmaceutical companies have to date principally been generic, but foreign investment and the transfers of technology and management systems that accompany this investment are accelerating the growth of a more sophisticated pharmaceutical industry. Foreign manufacturers of pharmaceuticals are beginning to establish R&D facilities in China. The biotech industry in China is also growing. According to one hearing panelist from the U.S. biotech industry, the Chinese government is supporting its development through the annual investment of over $600 million into universities, research centers, and labs. The Chinese government is encouraging Chinese nationals who have obtained Ph.D.'s in the life sciences field in the United States to return to China and is offering them incentives to do so.

China's Role in the Global Supply Chain. Global production networks dominate China's high-tech export environment. Foreign investment into China has provided capital, management and technology to Chinese production in various technology sectors. Taiwan firms are key investors and intermediaries in China's high-tech production networks.

Maintaining the U.S. Technological Edge. The U.S. role in global high-tech production chains is in the more skill and technology intensive activities, particularly in the R&D stage of production. American-developed technology advances and innovation has generally maintained the United States' status as a global economic leader. The Commission heard testimony from almost every panelist concerning the need for the United States to reinvest in its long-term human capital in order to maintain this technological edge. China currently graduates three times as many engineers as the United States at the bachelor's degree level. There is a great need for the U.S. Government to explore policies aimed at expanding educational opportunities in the mathematics and sciences fields, and for upgrading the U.S. technology infrastructure.

China's Regional Outreach. China has become more receptive toward working in a multilateral format, particularly groupings in which it can exercise a leadership role—such as the Asia Pacific Economic Cooperation (APEC) and the Shanghai Cooperation Organization (SCO). Moreover, China's growing economic influence in the region has enhanced its political leverage as well. This poses a challenge to ensure the United States is not excluded from the Asian region's economic and security forums and that China's role in these forums does not compromise U.S. goals in the region.

China's emergence as a center for high-tech manufacturing and R&D is one of the most significant dynamics of China's economic growth and an area the Commission will continue to follow closely as it poses significant economic and security challenges for the United States.

Yours truly,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

MARCH 10, 2004

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our hearing on February 6, 2004, on China's "Military Modernization and the Cross-Strait Balance." U.S. cross-Strait policy and U.S.-China relations are intertwined. Taiwan remains the key political and military flash point between the two countries, driving both China's military modernization efforts and U.S. military assistance to Taiwan.

The Commission is mandated by law (P.L. 108–7, Division P) to "review the triangular economic and security relationship among the United States, Taipei and Beijing, including Beijing's military modernization and force deployments aimed at Taipei, and the adequacy of United States Executive Branch coordination and consultation with Congress on United States arms sales and defense relationship with Taipei."

The Commission's hearing took place at a time of heightened tension in cross-Strait relations. China's ballistic missile build-up directed at Taiwan has been escalating in recent years. Such a build-up appears clearly designed to coerce Taiwan into accepting unification with China and/or to deter moves toward independence by Taiwan. In January, Taiwan President Chen Shui-bian announced his decision to hold a national referendum as part of the Presidential election balloting on March 20, 2004. The referendum would seek a national opinion on the question of whether Taiwan should deploy advanced anti-missile defenses to counter China's missile deployment and whether Taiwan should be negotiating a cross-Strait framework for peace and stability with Beijing. The response from Beijing, which views the referendum as a further move toward independence by Taiwan, has been one of strong condemnation and rhetoric, including threats of a possible military response. President Bush has publicly reiterated U.S. opposition to actions by either side that seek to alter unilaterally the status quo. Notably, he made such a statement in the presence of visiting Chinese Premier Wen Jiabao in December.

During our hearing on February 6, the Commission heard from senior State and Defense Department officials on current developments in U.S.-China-Taiwan trilateral relations, from experts on the parameters of U.S. commitments to Taiwan under the Taiwan Relations Act (TRA) and the role of Congress laid out in the TRA, and from analysts of China's military modernization programs and its military-industrial complex.

China's military modernization program. Between 1989 and 2002, as China's economy has rapidly expanded, China's official defense budget for weapons procurement grew more than 1,000 percent, significantly outpacing China's GDP growth. China's People's Liberation Army (PLA) has become a major buyer of foreign military technologies, and is now the principal purchaser of Russian military weapons and technology. China's increased military spending and acquisitions of foreign military technologies have greatly enhanced China's military capabilities.

During the late 1990s, the PLA began focusing its efforts toward developing military options and capabilities to prevent Taiwan from declaring independence. The PLA has undertaken programs designed to improve its force options against Taiwan and to deter and counter potential U.S. military intervention during any cross-Strait conflict. China's military modernization is focused on exploiting vulnerabilities in Taiwan's national and operational-level command and control system, its integrated air defense system, and Taiwan's reliance on Sea Lines of Communication for sustenance. At the same time, Taiwan's relative military strength appears likely to deteriorate unless Taiwan makes substantial new investments in its own defense.

The Commission also heard testimony that China's defense firms have significantly improved their R&D techniques and their production processes. As the PLA shifts away from purchasing complete weapon systems from foreign suppliers to acquiring military-related technology, China's defense production capabilities will become a critical factor in the PLA's long-term effort to renovate its force structure. China has been able to serialize the production of destroyers based on stealthy designs with improved air defense and anti-submarine capability. China has also improved its ability to serial produce ballistic missiles with an increase in annual production of short-range ballistic missiles (SRBMs) from 50% to 75%. However, despite rapid improvements, China's defense industry is not yet capable of producing global state of the art weapons systems on par with the United States.

China's continuing missile build-up opposite Taiwan is a serious challenge to Taiwan's security. The Defense Department's 2003 report to the Congress on China's military indicates that China now has approximately 450 short range ballistic missiles that can strike Taiwan and forecasts that this number will grow substantially over the next few years.

Given these developments, the Commission is concerned by reports that the European Union (EU) nations are debating whether to lift the EU's current arms embargo on China, imposed in the wake of the Tiananmen Square crackdown in 1989, and begin selling military equipment to Beijing. The Commission believes such action would undermine legitimate security concerns, be destabilizing to the region, and is unjustified by any improvement in China's human rights record, as documented in the Department of State's recently released Human Rights Report 2003.

> **Recommendation:** The Congress should urge the President and the Secretaries of State and Defense to strongly press their EU counterparts to maintain the EU arms embargo on China. Further, the Congress should request the Department of Defense to provide a comprehensive report to the appropriate committees of jurisdiction on the nature and scope of Russian military sales to China. In addition, Congress should urge the Executive Branch to continue its positive working relationship with the Israeli government to limit Israeli military sales to China.

Taiwan Relations Act (*TRA*). The Taiwan Relations Act gives Congress a joint role with the Executive Branch in the fashioning of U.S. cross-Strait policy, particularly with regard to how the U.S. should respond to cross-Strait conflicts and what arms the U.S. should sell to Taiwan to assist in its defense needs. Nonetheless, it appears that Congress has regularly been excluded from cross-Strait policy decisionmaking by a succession of Administrations. Congress has too often been notified only after the Administration has, in effect, made a decision on the sale of specific weapons to Taiwan. There has been some improvement in recent years in the consultative process between the Congress and the Executive Branch, but certain important documents or reports the Executive Branch has prepared on this subject have never been shared with the Congress. Given the potential for military conflict in the region, Congress needs to take a more direct oversight role in the process. The type of consultation that was envisioned by Congress at the time of passage of the TRA is going to be critical now in managing U.S. foreign policy towards China and Taiwan.

> **Recommendation:** Congress should enhance its oversight role in the implementation of the TRA. Executive Branch officials

should be invited to consult on intentions and report on actions taken to implement the TRA through the regular committee hearing process of the Congress, thereby allowing for appropriate public debate on these important matters. This should include, at a minimum, an annual report on Taiwan's request for any military aid and a review of U.S.-Taiwan policy in light of the growing importance of this issue in U.S.-China relations.

Recommendation: The responsible committees of Congress should request that the Executive Branch make available to them a comprehensive catalogue and copies of all the principal formal understandings and other communications between the United States and both China and Taiwan on the parameters of the trilateral relationship, as well as other key historical documents clarifying U.S. policy in this area.

The Commission will be closely following cross-Strait developments in the run-up and aftermath of the Taiwan Presidential election and referendum vote on March 20. We may develop additional recommendations regarding Congressional-Executive Branch coordination on U.S. cross-Strait policy as part of our upcoming Report to Congress later this spring.

Sincerely,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

Note:
Commissioner Bryen dissented from the Commission's majority in submitting these recommendations.

MARCH 4, 2004

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our February 5, 2004 hearing on "*China and the WTO: Compliance and Monitoring*."

China is not a fully developed market economy and was even less so at the time of its accession to the WTO. Integrating a large nonmarket economy into an international trading system that was designed for and dependent upon the efficient operations of markets posed a challenge of monumental proportions. To help meet this challenge, China's accession agreement required it to implement changes to its laws and economic system that had generally been a prerequisite for entering members. WTO members accepted China into the organization only after negotiating the most complex accession agreement in WTO history, one that reflected a large number of commitments by China to transition to a market- and rules-based economy and special safeguards for the domestic industries of other WTO members that could be significantly injured by surges of imports from China's non-market economy. Assuring that China implements these commitments is a large and important task for the U.S. Government.

The Commission held this hearing with the twin goals of assessing China's progress in complying with its schedule of commitments and gauging the adequacy of U.S. Government monitoring processes. At our hearing, the Commission received the testimony of officials from the U.S. Trade Representative (USTR) and the Departments of Commerce, State, and Agriculture. A panel of legal experts compared the contemporary situation with China's stated obligations and with U.S. expectations at the time of China's accession. The Commission also heard from representatives of agriculture, business, industry and labor organizations, many of whose members have first-hand knowledge of China's practical compliance.

China's Compliance

China has made only mixed progress towards complying with its WTO obligations. For instance, China has generally completed a broad range of tariff reductions in accordance with timetables stipulated in the accession agreement. It has revised or enacted a large number of laws and regulations to bring its trade system into better conformity with WTO norms. In the services sector, it has reduced capitalization requirements for some financial services operations, but requirements remain higher than can be justified. After sustained pressure from U.S. officials, China reduced barriers to U.S. agriculture exports through reform of tariff-rate quota implementation. Despite these and other positive steps, China has on the whole fallen behind its schedule of commitments, and in some areas has implemented new barriers to trade to compensate for those it is removing.

Some of the most egregious gaps between commitments and current practices include: rampant abuse and lax protection of intellectual property rights, lack of transparency in adopting and applying regulations, the use of technical or safety standards to unreasonably exclude foreign products—including non-science-based sanitary and phytosanitary standards on agricultural products—implementation of discriminatory tax incentives to encourage U.S. and other foreign semiconductor companies to move their manufacturing operations to China, and obstacles to the domestic distribution of imported products.

The Commission finds that:

- China has made progress on WTO compliance in absolute terms, but this progress toward compliance has decelerated to an unacceptably slow pace. Furthermore, some lowered barriers to trade have been replaced by new barriers that deny market access to U.S. exports of goods and services, a practice that we categorically reject.

Enforcement

While the Commission is satisfied that the U.S. Government is competently monitoring China's compliance, we question the enforcement effort to date. The U.S. has yet to file a single dispute against China in the WTO, despite numerous clear violations disclosed at our hearing. The Commission understands that something of a 'honeymoon' period was necessary for China to have the opportunity to implement its accession commitments and to afford the U.S. the time to review China's nascent track record. The two years that have passed since China's accession represent a period of sufficient length for such restraint and forbearance, a period which we now expect to come to a close.

The Commission also acknowledges the value of settling a potential dispute case through bilateral negotiations, which offer the promise of relief for afflicted U.S. industries on a compressed time scale. However, such negotiations will find greater success if accompanied by a history of determined use of the WTO dispute resolution mechanism when necessary. The Commission therefore urges continued bilateral discussions on the catalog of compliance gaps, but similarly advocates vigilant use of formal channels for redress when China fails to address grievances.

One area of monitoring we found to be particularly lacking is the WTO's Transitional Review Mechanism (TRM) for reviewing China's compliance. This annual review process was established as part of China's accession agreement to the WTO. U.S. negotiators expected the TRM to be a robust mechanism for monitoring China's WTO compliance and applying multilateral pressure for improvement. In practice, the TRM has been undermined by China's refusal to abide by standard WTO procedural methods such as responding in writing to requests for information from other member countries and its unwillingness to have TRM issues raised in WTO subsidiary committee meetings at a sufficiently early stage to have a meaningful dialogue on the concerns. China argues that the normal customs of the WTO do not apply because the TRM is a discriminatory measure applying only to China. The Commission notes that China's entry into the WTO was conditioned on China's acceptance of the TRM and other special provisions intended to compensate for the disjunction between WTO standards and China's non-market economy and underdeveloped legal system. China accepted and signed the WTO agreement that created and governs the TRM and therefore should desist from arguing that it is discriminatory and instead cooperate in making it a useful mechanism to improve its implementation of its WTO obligations.

The Commission finds that:

- The TRM has failed to live up to the expectations of the U.S. and other WTO members that it would be a comprehensive tool for measuring and evaluating China's compliance with the full range of its commitments and a robust mechanism for putting multilateral pressure on China to address compliance shortfalls.

U.S. Economic and National Security

The Commission believes that the Executive Branch is sufficiently monitoring China's compliance with WTO obligations, and providing its results to the Congress and the public at large in a timely manner. However, the Commission finds that too little attention has been paid to the security implications of China's participation in the WTO. American economic security rests on a broad foundation of economic activity, and actions to protect U.S. economic security will be bolstered by measures employed to compel China's compliance with its WTO obligations. Finally, the U.S. must take care to preserve its domestic industries whose health is directly related to important military capabilities.

Based on the record of this hearing and the Commission's other work on these issues to date, we present the following preliminary recommendations to the Congress for consideration. The Commission will continue to develop these recommendations and provide additional guidance in our annual Report to the Congress.

Preliminary Recommendations:

- The U.S. Government should signal clearly to China that its WTO 'honeymoon' period has ended, and that the U.S. will no longer hesitate to secure its rights through formal recourse to the WTO when necessary. Such a statement should accompany the first filing of a WTO case. The Congress should press the Administration to use the WTO dispute settlement mechanism and/or U.S. trade laws, including Section 301 provisions, to seek redress for China's practices in the areas of exchange rate manipulation, denial of trading and distribution rights, massive violations of intellectual property rights (IPR) that have cost U.S. firms billions of dollars, and government subsidies to export industries that harm the competitiveness of U.S.-based manufacturing firms.
- China's preferential value-added tax (VAT) treatment for domestically designed and produced semiconductors and other discriminatory policies are encouraging large foreign investments into semiconductor manufacturing facilities in China, leading to a global overcapacity in that industry that threatens U.S. producers. The Commission commends ongoing USTR efforts to resolve the issue expeditiously through negotiations, but now recommends that the U.S. forthwith file a WTO case on the matter.
- China's WTO obligations for curbing the abuse of intellectual property rights demand not only China's promulgation of appropriate legislation or regulations, but also concrete results in the reduction of IPR violations, which are thus far lacking. The U.S. should offer China assistance in implementing a program to curb the abuse of IPR that includes criminal penalties against its citizens who engage in such WTO-required practices. This offer should be coupled with an explicit timeline for implementation and realization of results. The timeline should also guarantee filing of a WTO case if the offer is rebuffed or its implementation unsuccessful.

- The U.S. should put in place procedures for consulting with trading partners at the outset of each new dispute over China's compliance. Particular efforts should be made to work closely with the EU, Japan, and others to ensure that China lives up to its WTO commitments.
- USTR and other appropriate U.S. Government officials should undertake strenuous efforts to reform the TRM process into a meaningful multilateral review and measurement of China's compliance with its WTO commitments. If this is unsuccessful, the U.S. Government should initiate a parallel process with the EU, Japan, and other major trading partners to produce a unified annual report by which to measure and record China's progress toward compliance. This measurement and evaluation should be provided in detail to Congress as part of USTR's annual report on China's WTO compliance.
- The U.S. Government should make optimum use of the special Section 421 and textile safeguards negotiated as part of China's WTO accession agreement. These important safeguards were designed to prevent our domestic industries from being forced into bankruptcy by surges of Chinese exports. Although the International Trade Commission has recommended that Section 421 relief be granted on a number of occasions, they have yet to be approved by the Executive Branch. Testimony was presented to the Commission that the Chinese Government has hired U.S. law and government relation firms to lobby the Executive Branch to ensure that the special safeguards are not utilized. This puts private sector U.S. firms seeking implementation of the safeguards at a disadvantage and may have the effect of nullifying important safeguards Congress relied on in approving PNTR for China.
- The Congress should amend our countervailing duty laws to permit their usage in relation to non-market economies. For example, the Chinese Government makes non-market based loans to its state-owned enterprises, enabling them to export subsidized goods to the U.S. market that harm the competitiveness of U.S. manufacturers.
- The transfer of technology by U.S. investors in China where it is a WTO-inconsistent condition of doing business with Chinese partners under Part I, Section 7(3) of China's Accession Protocol remains an enduring security concern for the U.S. The Commission understands there has been some reduction of this practice, but condemns any remaining instances of it and asks U.S. companies to help maintain U.S. Government vigilance by reporting any continuing or future occurrences.

We hope that this hearing record and the Commission's above findings and recommendations will assist the Congress in assessing a complex but vital subject of U.S.-China economic relations. As always, we stand ready to present to any interested Committees or

Members the Commission's research and analysis on this and any other subject contained in the Commission's mandate.

Sincerely,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

Note:
Commissioner Bryen dissented from the Commission's majority in submitting these preliminary recommendations.

MARCH 4, 2004

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our field investigation in Columbia, South Carolina on January 30, 2004. This field investigation titled, "*China's Impact on the U.S. Manufacturing Base*," gave the Commission the opportunity to examine the real, on-the-ground impacts of fast increasing Chinese imports and off-shore transfers by U.S. firms on the U.S. manufacturing base.

This investigation revealed the extent of the difficulties faced by America's manufacturers, workers and communities in the face of manufacturing competition from China and the urgent need for action to deal with them. The location was vital to the message. According to U.S. Department of Labor statistics, between November 2002 and November 2003, Columbia, South Carolina lost 12,000 jobs, which represents a 4 percent decrease, the largest percentage of jobs lost that year for any metropolitan area in the United States. The State of South Carolina lost 2.6 percent of its jobs over that same time period, the largest percent decrease of any State. In the manufacturing sector, South Carolina has lost 63,000 jobs, a nearly 20 percent decline over the past three years.

Representing bipartisan Congressional concerns about this matter, Senators Ernest F. Hollings (D–SC) and Lindsey O. Graham (R–SC) took part in the proceedings and expressed to the Commission their views regarding what they believed to be China's unfair trade policies, particularly its artificially undervalued currency, as well as export subsidies, dumping, and other WTO-inconsistent practices. Panelists representing South Carolina's manufacturing industries—including textile, apparel, steel and plastics—gave vivid descriptions of the bottom line challenges they face from such Chinese competition.

Unfair Chinese Trade Policies

China's continued rapid growth in manufacturing, U.S. companies' willingness to move production abroad in order to cut costs, often referred to as offshore outsourcing, and China's policies aimed at encouraging growth and investment in its manufacturing base were discussed in depth at this investigation. In assessing causes of the worsening U.S. trade deficit and loss of U.S. manufacturing jobs, participants pointed to China's lack of labor and environmental standards, rampant infringement of intellectual property rights, state subsidization of its state-owned industries through preferential tax treatment, access to capital, and other benefits, and its record of lagging compliance with many important commitments under its WTO accession agreement. These factors have undermined the competitiveness of U.S. manufacturing firms in South Carolina and elsewhere in our country.

Overall, many of the hearing participants were exceedingly critical of the U.S.' trade strategy and policies. Many claimed that policies aimed at promoting free trade were in fact encouraging the transfer of manufacturing and research and development to China to the detriment of the U.S. economy.

Industry Specific Considerations

Steel: Over the last three years South Carolina's steel and metals industry has experienced a dramatic decline. Between November 2000 and November 2003, South Carolina's primary metals and fabricated metals industries lost a combined 7,300 jobs, representing contractions of 20 percent and 18.6 percent, respectively. According to the U.S. Department of Commerce, between 2000 and 2002, South Carolina's exports of primary metal manufactures fell from just over $126 million to approximately $76 million.

Panelists representing U.S. steel firms described the effect of competition from China on their industry. They noted that China's steel industry—which benefits from extensive capital subsidies from China's state-owned banks—has grown 10 percent in the last 12 months resulting in soaring demand for scrap steel and other inputs. One particularly ominous concern expressed by hearing panelists is that a slow down in the Chinese economy could reduce its domestic demand for steel and lead to dumping of subsidized Chinese steel in U.S. markets, resulting in further price pressures on U.S. steel producers.

Textiles and Apparel: The U.S. textile and apparel industries have suffered dramatically since China entered the WTO in 2001. Over 50 American textile plants closed in 2003, resulting in the loss of 49,000 jobs. One out of every four U.S. textile jobs that existed in January 2001 no longer exists. South Carolina's textile industry has suffered significant losses. In 2003, 4,000 textile workers in South Carolina lost their jobs. This was second only to North Carolina—whose textile industry lost 13,600 jobs.

Textile manufacturers and union representatives expressed deep-seated concern that the expiration of the Multifiber Arrangement on January 1, 2005 would allow China to capture a vast percentage of the U.S. market and decimate the remaining U.S. textile industry, which still employs 630,000 people. Participants also alerted the Commission that new trade agreements, such as the Central American Free Trade Agreement (CAFTA), provide an opportunity for the transshipment of Chinese textiles through third country ports, which would undermine the China specific textile safeguards imposed by the U.S. against a range of Chinese goods in December.

To guard against surges of Chinese textile imports from subsidized state-owned factories, the U.S. negotiated a special textile safeguard as part of China's WTO accession agreement that allows the U.S. and other WTO members to impose restrictions on Chinese textile imports when they pose "a significant cause of material injury, or threat of material injury to the domestic industry." Although China entered the WTO in January 2002, the U.S. Government did not publish procedures to implement this safeguard until May 2003, and first used this provision in November 2003 when the Bush Administration announced the imposition of textile safeguards on select categories of knit fabric, dressing gowns, robes and bras imported from China. These year-long restraints became official on December 23, 2003. The Commission believes the U.S. Government has not been aggressive enough in using this textile safeguard.

Based on the record of this hearing and the Commission's other work on these issues to date, we present the following preliminary recommendations to the Congress for consideration. The Commission will continue to develop these recommendations and provide additional guidance in our annual Report to the Congress.

Preliminary Recommendations:

- The United States Trade Representative and the Department of Commerce should immediately undertake a comprehensive investigation of China's system of government subsidies for manufacturing, including tax incentives, preferential access to credit and capital from state-owned financial institutions, subsidized utilities, and investment conditions requiring technology transfers. USTR and Commerce should provide the results of this investigation in a report that lays out specific steps the U.S. Government can take to address these practices through U.S. trade laws, WTO rights and by utilizing special safeguards China agreed to as part of its WTO accession commitments.
- The U.S. tax code should be restructured to eliminate incentives for U.S. businesses, particularly manufacturing, but also services and high technology companies, to shift production, services, research and technology abroad. Tax incentives which reward relocation abroad should be removed from the tax code as soon as possible.
- USTR should press for provisions during the Doha Round that allow for increased penalties on firms that have been found in violation of anti-dumping laws on multiple occasions.
- The Administration should undertake a comprehensive review and reformation of the government's trade enforcement infrastructure in light of the limited efforts that have been directed at enforcing our trade laws. Such review should include consid-

eration of a proposal by Senator Hollings (D–SC) at our hearing to establish an Assistant Attorney General for International Trade Enforcement in the Department of Justice to enhance our capacity to enforce our trade laws. Moreover, the U.S. Government needs to place a renewed emphasis on enforcement of international labor standards and appropriate environmental standards.

- If we experience new surges of imports that threaten the U.S. steel industry, the United States should claim a national security exemption under Article XXI of the WTO for the steel industry because of its importance to our military manufacturing sector and our national security.
- The United States should work with other interested WTO members to convene an emergency session of the WTO governing body to extend the Multifiber Arrangement at least through 2008 to provide additional time for impacted industries.
- The U.S. Government should more fully and effectively make use of the Section 421 China-specific safeguard and the China textile safeguard available to WTO members. These were important provisions negotiated into China's WTO accession agreement and intended to provide relief for domestic industries hit with surges of imports from China.
- The leadership and appropriate Committees of Congress should convene a summit of leaders of the textile industry, its workers and their representatives, impacted communities and others to help define the crisis in the domestic textile and apparel industry as it related to trade with China and to define a plan of action to help address predatory trade practices and ensure that domestic capabilities exist to meet our Nation's economic and national security needs in this important area. As part of that effort, the Summit should:
    - Review recently completed free trade agreements and those under negotiation so as to avoid loopholes such as that present in the Central American Free Trade Agreement (CAFTA) that grant the Chinese textile industry the opportunity to circumvent American safeguard and tariff provisions.
    - Examine Customs Service efforts to monitor and inspect shipments of textile and apparel imports to ensure that the law is being appropriately enforced and determine what increases in resources are necessary to protect the rights and interests of the industry and its workers.

Community Impacts

The Commission heard powerful testimony on the extent to which trade-related economic dislocations have impacted many South Carolina manufacturing communities. The Commission was told that the significant loss of jobs in South Carolina due to import competition and off-shoring had resulted in externalities such as the erosion of the local tax base in many communities and the accompanying decline of law enforcement, infrastructure, and health services and had a debilitating impact on families and quality of life.

Preliminary Recommendations:

- U.S. trade policies have contributed to current high levels of unemployment. The Administration should authorize another unemployment insurance extension in an attempt to provide unemployed workers with a greater amount of time with which to locate employment.
- A new type of education program should be enacted for long-term and effective adjustment to the employment impacts of outsourcing and relocation abroad. Further, a series of Federal and local training programs in coordination with private U.S. firms aimed at tailoring education to meet future needs should be developed.
- The Congress should fund information sessions and a public awareness campaign to inform laid off workers about existing and newly established programs such as Trade Adjustment Assistance (TAA). Petitions for TAA eligibility should be processed expeditiously.

Thank you for your consideration of our recommendations. In addition to the above findings we commend you to also review the record of our September 25, 2003 hearing on China's investment, industrial, and exchange rate policies, our February 5, 2004 hearing on China's WTO compliance and a February 12–13, 2004 field investigation in San Diego on U.S.-China high-technology trade. We hope you will find all of these proceedings helpful as the Congress continues its assessment of the implications of China's growing role in global trade and manufacturing.

Sincerely,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

Note:
Commissioners Bryen, Reinsch, and Wortzel dissented in whole or in part from the Commission's majority in submitting these preliminary recommendations.

December 23, 2003

The Honorable Ted Stevens,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. Dennis Hastert,
Speaker of the House, Washington, D.C. 20515

Dear Senator Stevens and Speaker Hastert:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our hearing held December 4, 2003, on "China's Growth as a Regional Economic Power: Impacts and Implications."

As you know, the Commission is mandated by law (P.L. 108–7, Division P) to assess, among other areas, "the extent of China's 'hollowing out' of Asian manufacturing economies, and the impact on United States economic and security interests in the region; [and] review the triangular economic and security relationship among the United States, Taipei and Beijing." Our hearing was focused on exploring trends in these areas and in the broader spectrum of China's regional relations.

The December 4th hearing examined from several perspectives the regional impacts of China's rapid growth as an economic power. Asian governments, the international media, and academic experts have increasingly noted China's growing importance to trade and investment patterns in Asia. They also note China's more assertive regional economic diplomacy, including proposals to enter into liberalized trading arrangements with members of the Association of Southeast Asian Nations (ASEAN) and the Shanghai Cooperation Organization (SCO) as well as the countries of Northeast Asia. We asked expert panelists to provide their perspectives on these dynamics and on appropriate U.S. policy responses.

Based on the hearing, we present the following preliminary findings:

- In recent years, China has adopted a softer yet more confident and proactive posture in its relations with its Asian neighbors. China's various bilateral "partnership" relationships—that once seemed largely symbolic—have gradually taken on greater substance.
- In contrast to fairly passive advocacy in the past, China is now actively promoting the establishment or strengthening of regional multilateral institutions, such as the Shanghai Cooperation Organization in Central Asia and the ASEAN "Plus One" (China) and "Plus Three" (China, Japan, South Korea) partnership fora.
- Some observers conclude that China is filling a void in the region left by U.S. preoccupation with Iraq and the global war on terrorism. China touts its policy of "non-interference" in the internal affairs of other states and contrasts its hands-off approach to that of the U.S., which actively pursues an agenda to combat terrorism and to promote human rights and democratic governance. Aside from reiterating the importance of partners accepting its "One China principle," China makes few political demands on its Asian neighbors. China does not push human rights, labor or environmental standards in its diplomacy.
- China's regional strategy appears to be subordinate to its global economic strategy, which is to maintain access to the open multilateral trading system on which its rapid export-driven growth now depends.
- China's regional strategies are in part driven by its energy security needs, a topic the Commission explored during a hearing on October 30, 2003. For example, major pipeline projects are being planned to connect China to oil and gas fields in Central Asia and the Russian Far East and to establish liquefied natural gas terminals to receive shipments from Australia and Indonesia.

- China's export-driven economic boom has been fueled by a high volume of inward Foreign Direct Investment (FDI), particularly in the wake of China's entry into the World Trade Organization (WTO). In the view of one witness, China's membership in the WTO has sharply reduced the perceived "risk premium" for FDI in China and intensified the trend. This has implications for all regional economies, but especially for the countries of Southeast Asia, which have already experienced a relative decline in FDI flows and could lag behind China in technological progress.
- One panelist noted that "hollowing out" of some industrial sectors in the region was taking place due to China's export drive, attraction of FDI, and development as a major manufacturing power. This was particularly true in Taiwan, which of all the Asian industrial economies has the heaviest "trade dependence" on China, but it also has affected Northeast and Southeast Asian nations. At the same time, panelists acknowledged that for now the high growth in exports from the rest of Asia to "feed" China's manufacturing sector was taking some of the sting out of "hollowing out." The question is whether China will move up the technology ladder to such an extent that its current imports from the rest of Asia will slow or change in composition. Several of our panelists concluded that Japan, South Korea, Taiwan and the ASEAN nations have no choice but to rise to China's challenge by advancing their own technological base, if they want to remain competitive and improve their standards of living.
- In the region there is a disquieting perception that the U.S. was largely indifferent to Asia's fate during the 1997–98 regional financial crisis and has ignored a number of Asia's developmental concerns in its preoccupation with the global war on terrorism and the North Korean nuclear threat.

Some of these dynamics were apparent at the recent APEC meeting in Bangkok where China projected itself as a more attentive and profitable alternative to the U.S., depicting the latter as preoccupied with terrorism and security relations. Many Asian leaders left Bangkok praising Chinese President Hu's economic initiatives and wondering why President Bush seemingly downplayed economic concerns. Likewise, after visits by Presidents Bush and Hu to Australia, the Asian press reviewed Hu's performance more favorably. Such perceptions can limit the U.S. Government's ability to secure the cooperation of Asian nations in achieving our priority objectives.

The implications of China's economic rise vis-à-vis the U.S. are significant. Chinese economic and political practices represent a troublesome alternative to U.S. norms. International labor standards are essentially ignored in the rush for production, transparency is clouded by corruption and insider deals, environmental protection takes a back seat, and democratic principles are suppressed by authoritarian "realism." Yet, the "success" of China's model is no doubt making a strong impression on its Asian neighbors. An important multilateral vehicle that the U.S. could use to reassure Asian partners is APEC—the Asia-Pacific Economic Cooperation forum. APEC should be strengthened by more active

American participation, innovation, and high-level political support for its regional economic agenda. Our long-term economic and security interests in Asia are too important to fall victim to a distracted America.

As the Congress deliberates on issues concerning U.S. interests in Asia and considers how to strengthen American diplomacy in the region, the economic rise of China is a key factor to assess. Through its economic success, China is exercising a more effective and assertive regional diplomacy and exercising enhanced political influence in Asia.

Yours truly,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

DECEMBER 17, 2003

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit a record of our hearing of October 30, 2003, on China's energy needs and strategies and the implications for global energy markets and China's geopolitical relations.

The Commission's statutory mandate (P.L. 108–7, Division P) calls on us to assess, among other issues, "how China's large and growing economy will impact upon world energy supplies and the role the United States can play, including joint R&D efforts and technological assistance, in influencing China's energy policy." The Commission's mandate further directs it to examine China's economic and strategic relations with its regional neighbors and other countries, of which China's energy policies are an important component.

During our hearing we heard testimony from nine distinguished experts on the economic and security dimensions of China's energy strategies, including Guy Caruso, Administrator of the Department of Energy's Energy Information Administration, and former Director of Central Intelligence R. James Woolsey. The Commission also conducted a luncheon discussion on the geoeconomic and geopolitical aspects of China's energy strategies with former Secretary of Defense and Energy James R. Schlesinger.

The key issue raised in the hearing is whether China will continue to pursue new energy supplies in the Middle East and elsewhere in competition with, or cooperation with, the U.S. and other consuming nations. The continuation of China's unilateral approach could provide additional price leverage for OPEC member countries. It may also encourage China to offer incentives to energy supplier nations, as it has in the past, including missile and WMD components and technologies, for secure long-term access to energy supplies. This practice substantially undermines U.S. global nonproliferation policies. On the other hand, China could pursue its urgent quest for new energy on a more multilateral basis, working with the U.S. and other nations to manage access to supplies, and put into place, for example, the coordinated release of oil stocks to counter future price spikes. Such cooperation would preferably involve the kind of arrangements already in force within the framework of the International Energy Agency (IEA), benefiting both U.S. energy security and nonproliferation goals. China's extraordinary rate of economic growth has made it a rapidly growing consumer of energy. Currently China stands as the world's second largest consumer of energy (behind the United States) and its third largest consumer of oil (behind the United States and Japan). With this increasing demand has come an increasing reliance on imported energy. China became a net oil importer in 1993 and now imports nearly 2 million barrels per day, projected to increase to more than 6 million barrels per day by 2020, making it a major factor in world energy markets.

China has a comprehensive energy security strategy, consisting of demand reduction, diversification, leveraging bilateral relationships with key Middle East suppliers, building stronger ties with Russia, and establishing a market position in Central Asia. Currently, coal dominates China's energy consumption (65 percent). This poses a tremendous environmental challenge to both China and the world as much of this consumption involves unwashed coal and has lead to a surge in air pollution and emissions of greenhouse gases. In this area, China is proceeding with improving its energy efficiency, and its use of clean coal technology, coal liquefaction and gasification and coal-bed methane development, exploration, and production.

Oil is the second largest source of energy for China, accounting for 25 percent of its energy consumption, and China will soon be the world's second largest oil importer after the U.S. The world's major oil importing nations belong to the multilateral framework of the IEA. China is the largest oil-consuming nation that does not participate in the IEA system, including the IEA's coordination of joint releases from strategic reserves to counter politically motivated supply reductions by oil producers. China has opted to pursue bilateral arrangements and investment in energy production and a possible small strategic oil reserve to address its energy security concerns.

To achieve its goal of diversifying oil import sources, and to enhance its energy security, China has entered into energy deals with a number of countries, including some—Iran and Sudan—that are on the State Department's list of terrorist-sponsoring states. These arrangements are troubling, especially to the extent they might involve political accommodations and sales or other transfers of weapons and military technologies to these nations.

In sum, China's growing energy demands, particularly its increasing reliance on oil imports, pose economic, environmental, and geostrategic challenges to the United States. The Commission will continue its thorough examination of China's energy needs and strategies and advise the Congress as appropriate with regard to developing appropriate U.S. policies to influence China's energy policies in a manner consistent with U.S. interests.

Yours truly,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

OCTOBER 14, 2003

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our hearing on September 25, 2003, on "China's Industrial, Investment and Exchange Rate Policies: Impact on the United States." These issues are at the forefront of U.S.-China economic relations, particularly in light of the impact that China's exchange rate and industrial policies are having on global investment trends and on U.S. manufacturing and trade deficits. We are aware that both the Executive Branch and Congress are examining initiatives to address U.S. concerns in this area and therefore we outline here several of the Commission's key findings and recommendations arising from our hearing and research activities to help inform Congressional deliberations.

As you know, the Commission is mandated by law (P.L. 108–7, Division P) to examine, among other areas, China's economic policies and the United States trade and investment relationship with China, including assessing the qualitative and quantitative nature of the shift of United States production activities to China. This latter charge includes examining the relocation of high-technology, manufacturing and R&D facilities to China and the effect of these transfers on United States economic security, employment and the standard of living of the American people.

At our September 25 hearing, the Commission heard testimony from a number of Members of both the House and Senate, including the principal sponsors of various Congressional initiatives designed to address China's exchange rate practices. Representing bipartisan Congressional concerns, these Senators and House Members have introduced differing bills aimed at providing appropriate incentives to the Chinese government to end its apparent mercantilist trade policies, most particularly its artificially undervalued currency, as well as other unfair trade practices such as export subsidies, dumping, and other WTO-inconsistent practices. The Members testified that such practices by China amounted to a forced redistribution of trading and investment balances that violate the principles of free and fair trade embodied in China's WTO accession obligations as well as in its bilateral trade arrangements with the United States and other international agreements, such as the IMF charter. One result of China's unfair trade practices has been its rapid accumulation of foreign exchange reserves, now totaling some $355 billion, the second highest in the world after Japan.

Exchange rate policies. Based on our examination of this issue, it appears clear that China continues to follow a policy of one-way market interventions by the government to maintain its currency at a level that economists estimate is between 15–40 percent undervalued. In this regard, China is purchasing U.S. dollars at an estimated rate of $120 billion per year to prevent appreciation of its currency against the dollar. In assessing causes of the worsening U.S. trade deficit and loss of U.S. manufacturing jobs, some hearing witnesses argued that the lack of net new savings in the U.S. economy, the global mobility of factors of production and/or low labor costs in China were the principal factors. In any event, based on the evidence presented, we believe the inappropriate exchange rate between the Chinese yuan and the dollar is negatively impacting the competitiveness of U.S. manufactured goods and is contributing to a migration of world manufacturing capacity to China and an erosion of the U.S. manufacturing base.

Section 3004 of the Omnibus Trade and Competitiveness Act of 1988 (22 U.S.C. Sec. 5304) requires annual reports from the Department of Treasury on foreign countries' exchange rate policies and requires the Secretary to enter into negotiations on an expedited basis with countries found to be manipulating their currencies to gain an unfair competitive trade advantage. Past reports from the Treasury on China have sidestepped this conclusion, which appears now to be inescapable. The Commission believes it is clear that China, in violation of both its IMF and WTO obligations, is in fact manipulating its currency for trade advantage and therefore finds it imperative that the Treasury immediately and forcefully enter into negotiations with the Chinese government to resolve this matter. China's continued maintenance of an undervalued exchange rate with the U.S. dollar will continue to promote major distortions in the flow of trade and investment, to the detriment of American companies and workers, and therefore requires decisive action by Washington.

Recommendation: The Treasury Department should make a determination in its foreign country exchange rate report to Congress that China is engaged in manipulating the rate of exchange between its currency and the U.S. dollar to gain an unfair competitive trade advantage and immediately enter into formal negotiations with the Chinese government over this matter. Should these efforts prove ineffective, the Commission urges the Congressional leadership to use its legislative powers to force action by the U.S. and Chinese governments to address this unfair and mercantilist trade practice. For the near future, continued vigorous development of such legislative initiatives as were outlined by Members of Congress during our hearing, linking China's performance on its exchange rate policies to its continued full access to the U.S. market, appears essential to ensure the appropriate level of effort by both governments to this matter.

China's Investment and Industrial Policies. China has attracted a total of over $400 billion of foreign direct investment (FDI), most of it in the last six years. This compares with $1.3 trillion for the U.S., $497 billion for the U.K., $482 billion for Belgium-Luxemburg, and $480 billion for Germany. As FDI flows to China are now expanding by over $50 billion per year, China will soon have accumulated the second largest stock of FDI in the world.

Our hearing indicated that China's undervalued currency is just one of several factors behind that country's success in attracting massive inflows of FDI, particularly into its manufacturing sector. Our hearing examined the extent to which China's industrial policies have played a role. In this regard, we learned that:

- China has pursued industrial policies that have catalyzed its growth as a manufacturing powerhouse, particularly in increasingly higher-technology production. The Chinese government has designated a number of "pillar industries" and pursued a strategy of "picking winners" among China's emerging high-tech or industrial enterprises.
- Manufacturers in China are supported through a wide range of national industrial policies, which include: tariffs; limitations on foreign firms' access to domestic marketing channels; requirements for technology transfer by foreign investors; government selection of partners for major international joint ventures; preferential loans from state banks; privileged access to listings on national and international stock markets; tax relief; privileged access to land; and direct support for R&D from the government budget.

Recommendation: The United States Trade Representative and the Department of Commerce should identify whether any of China's industrial policies are inconsistent with its WTO obligations and engage with the Chinese government to mitigate those that are significantly impacting U.S. market access. Appropriate Congressional Committees should be fully briefed on the actions the agencies are taking to resolve these issues.

Recommendation: The Commission believes it is essential that U.S. policymakers have a clearer, more comprehensive, and timely picture of global investment and R&D flows to China, particularly in the manufacturing sector. The Commission's 2002 Report to Congress urged Congress to consider establishing an enhanced, mandated corporate reporting system to capture better this information by requiring firms to report "their initial investments in China; any technology transfer, offset, or R&D cooperation agreed to as part of the investment; the shift of production capacity and job relocations resulting from the investment, both from within the United States to overseas and from one overseas location to another; and contracting relationships with Chinese firms." We believe the need for such a system has only increased in urgency since our 2002 Report and again urge Congress to consider taking such action.

Impact on U.S. Economy. In his September 15, 2003 prepared remarks at the Detroit Economic Club, Commerce Secretary Don Evans reports that "*the President believes that our economic and national security require a stable, robust manufacturing sector that produces sophisticated and strategically significant goods here, in the United States.*" Manufacturing employs 14 percent of the American workforce, but has accounted for nearly 90 percent of all the job losses since total U.S. employment peaked in March 2001. Over 2.7 million American factory jobs have been lost over the past three years, roughly one in every six manufacturing jobs.

At our September 25th hearing the Commission heard testimony that supported a conclusion that China's undervalued currency and government investment strategies are having a deleterious effect on the competitiveness of U.S. manufactured goods and contributing to a migration of world manufacturing capacity to China, with a concurrent erosion of the U.S. manufacturing base.

Recommendation: The Commission believes that the President's pending Manufacturing Initiative should include provisions that strengthen the competitiveness of U.S.-based manufacturers in light of the growing shift of production to China, especially high-tech and R&D. The Initiative should address de facto Chinese government subsidies, particularly those not covered under the WTO, such as tax incentives, preferential access to credit, capital, and materials, and investment conditions requiring technology transfers.

It is the hope of the Commission that the results of this hearing will contribute to the fashioning of legislation by the Congress which will help to illuminate the economic impact that China is having on U.S. producers, better identify unfair Chinese trade practices, and steer Chinese economic practice into more sustainable and fairer channels.

Yours truly,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

AUGUST 12, 2003

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510.
The Honorable J. DENNIS HASTERT,
Speaker of the House, Washington, D.C. 20515.

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our hearing on July 24, 2003 examining China's proliferation policies and practices in the post 9/11 era, focusing in particular on its role in the developing North Korean nuclear crisis.

As you know, the Commission is mandated by law (P.L. 108–7, Division P) to "analyze and assess the Chinese role in the proliferation of weapons of mass destruction and other weapons (including dual use technologies) to terrorist-sponsoring states, and suggest possible steps which the United States might take, including economic sanctions, to encourage the Chinese to stop such practices." The Commission heard testimony from current and previous Administration and Intelligence Community officials, as well as a range of outside experts, on the current state of Chinese proliferation practices, on the events unfolding with regard to North Korea's nuclear program and on the implications of these developments for U.S. national security.[1]

We addressed the efforts of the Chinese government in the post 9/11 period to curtail its proliferation practices, which have served as an issue of contention for many years, the quality of its enforcement of newly-established export controls for weapons of mass destruction (WMD), and the effectiveness of current U.S. sanctions laws and practices. Witnesses provided a number of recommendations for encouraging the Chinese government to strengthen its commitment to curtail such proliferation activities, and to address continuing shortcomings of its export control system, as well as to review the adequacy of the Non-Proliferation Treaty.

China's role in cooperating with the United States in addressing the North Korean nuclear crisis was a priority issue in the hearing, given the urgency of this national security challenge. The scope and secrecy of its nuclear weapons program, coupled with a North Korean history of deception and lack of respect for agreements it has previously entered into, its willingness to export missiles and components of WMD, its economic dependence on those exports, and the potential for North Korea to become a near-term exporter of fissile materials as well as complete nuclear weapons are clearly a matter of supreme importance for the U.S. Therefore, the Commission believes the extent of Chinese cooperation in achieving an irreversibly de-nuclearized Korean peninsula is a key, if not the key, test of the U.S.-China relationship in the current period. China's recent diplomatic efforts in helping to secure North Korea's agreement to engage in the upcoming multiparty talks is encouraging, but must be followed up by the active use of its substantial leverage to persuade North Korea to freeze its reprocessing efforts and dismantle its nuclear weapons and ballistic missile programs, and to accommodate an intrusive international verification regime, which ensures the effective implementation of any agreement that is ultimately reached.

The stakes of the upcoming multiparty talks for U.S. national security and, indeed, the viability of nonproliferation programs globally, are enormous. Given those stakes, and the long history of Congress' involvement in fashioning and approving agreements dealing with arms control and issues of such national importance, we, the Chairman and Vice Chairman, believe that the building of a bipartisan consensus underpinning the goals and outcome of such negotiations argues for an early, informed and reinforcing role for

[1] The classified portion of this hearing record, at the codeword level, is also available for the use of Congressional Committees and cleared staff in S–407, the Capitol.

the Congress. If Congress is fully engaged and vested in any future agreement with North Korea it would substantially improve prospects for a durable consensus between the two branches on this vital matter.

Yours truly,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman

JULY 3, 2003

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the second volume of our hearings, those conducted by the Commission from September 23, 2002 through June 5, 2003, pursuant to P.L. 106–398 (October 30, 2000), as amended by P.L. 107–67 and 108–7.

As you know, the U.S.-China Economic and Security Review Commission is mandated by Congress to examine, among other areas, media control in China and to make recommendations to the Congress on this issue where appropriate.

On June 5, 2003 the Commission held a hearing on China's media and information control system, with particular emphasis on Internet censorship. As demonstrated in response to the recent SARS outbreak in China, such censorship is pervasive and continuous, and the Chinese government puts a high priority on its control mechanisms. The hearing reinforces our understanding that promising technologies recently developed by U.S. companies demonstrate the capability of breaking through this Chinese Internet firewall with a high degree of confidence, based on actual performance over the last year. We believe that the provision of additional modest financial resources in FY 2004 to these efforts could result in dramatic increases in the number of users in China who would be able to access uncensored information on the Internet. We have been told by U.S. Government officials working in this area, as well as knowledgeable private entrepreneurs involved in Internet anticensorship efforts, that such efforts could result in reaching critical thresholds of Chinese Internet users whereby the information control system of the Chinese government would be greatly degraded. Some U.S. firms working on such initiatives have told us that this level of resources could allow them to expand uncensored Internet access to some 1.5–2 million Chinese Internet users. Authorizing legislation—the "Global Internet Freedom Act"—has been introduced on a bipartisan basis in both chambers and is aimed at enhancing the U.S. Government's resources and capabilities to promote the development and use of technologies to allow access to the worldwide web by users in closed societies throughout the world.

On December 11, 2002, the Commission took testimony from Ms. HE Qinglian, a well-known dissident who emigrated to the U.S. in 2001, and Mr. CHENG Xiaonong, Princeton University, to discuss "Corruption's Impact on Governance, Politics, and Policies" in China. The third hearing included in this document during this reporting period focused on "Chinese Leadership Succession and Its Implications."

To date, the Commission has held twelve hearings and the Commission published the first volume of its record of public hearings, which were enormously valuable in informing the Commission and the public on the evolving relationship between the United States and the China, particularly in the economic arena. We plan to publish quarterly reports and transcripts of our hearings. Congress mandated nine specific areas for the Commission's work in 2003–2004, including proliferation practices, economic reforms and U.S. economic transfers, energy, role of U.S. capital markets, corporate reporting, regional economic and security impacts, U.S.-China bilateral programs, WTO compliance, and media control by the Chinese government. The congressional mandate specifying the areas of work and study the Commission will focus on begins on page 235. The Commission plans to issue its second annual report to Congress in April 2004.

Yours truly,

Roger W. Robinson, Jr.
Chairman

C. Richard D'Amato
Vice Chairman